Audit's® NEWS ANALYSIS OF SECURITIES OF REAL ESTATE INVESTMENT TRUSTS

Realty Trust Review

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INVESTMENT STRATEGY AND SELECTION ISSUE

INVESTMENT STRATEGY: MARKET SURGE AND RECESSION CALL FOR PORTFOLIO REVAMPING

The Dow Jones Industrial Index has cracked the 900 level to fall back slightly, and volume is heavy. Despite programmed selling when the market moves above 900, gainers continue to outpace losers as the large amount of money being moved from income vehicles into equities now that yields have plunged provides strong support for stock prices. As yet, the recession has had no effect on the market climb; however, second quarter earnings reports are only beginning to trickle in.

These considerations point to the need to examine portfolio holdings. Current high market prices for some of our recommended stocks raise the question of profit taking; alternatively, it would be desirable to hold on to the stocks to obtain capital gains treatment.

The potential for a stock market dive as the impact of the recession is felt on earnings and share prices also remains a question, and we feel that additions to your portfolio at this time should meet one of two criteria: trust earnings should be relatively invulnerable to the recession, or the trust share price should be poised for gains on the strength of special considerations.

With all of this in mind, in this issue we examine stocks in three categories. We advise you on acting on No. 1-Ranked shares which have seen the bulk of their gains but which have not yet qualified for capital gains treatment. We look at some of the realty trusts which have large California holdings. The California economy will not feel the bite of the recession nearly so severely as the rest of the nation, meaning that consumers will keep buying (helping overage rents) and real estate prices will stay up (as construction continues). Finally, we have keyed in on a couple of situations where potential events would have a favorable impact on stock prices, interesting speculations whatever the course of the market.

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CALIFORNIA REITS: PORTFOLIO YIELDS GROWING, BOOK VALUES BOOSTED BY PROPERTY SALES

BankAmerica Realty Investors (17-3/4 bid, OTC), based in San Francisco, has as its stated investment objective the ownership of equity interests in real estate; while mortgages amounting to $94 million comprise 55% of the trust's investment portfolio, some three-fourths of these are mortgages on real estate owned by the trust. Investments in properties amount to $76 million, about evenly divided between owned real estate and land purchase leasebacks.

The trust portfolio is broken down as follows: shopping centers, 38%; apartment buildings, 26%; hotels, 13%; office buildings, 11%. About 57% of trust investments are located in California, with the balance divided among 14 other states. The two largest individual investments are a regional shopping center located in Fremont, Calif. (9% of the portfolio, in real estate and mortgage), and a garden apartment in Menlo Park (7%). Three parcels of land underlying regional shopping centers in Los Angeles account for 11%.

Performance of the trust's total investment portfolio has been steadily improving, attributable to the strong performance of equity investments. In the first nine months of fiscal 1980, ended in April, the yield on the total portfolio was 12.7%, against 10.2% for all of fiscal 1979.

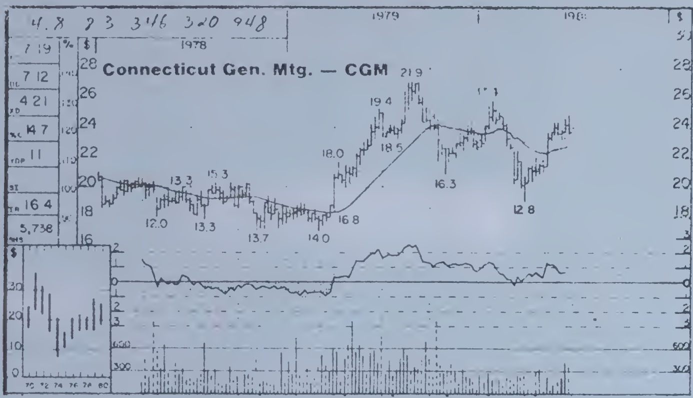
Components of the fiscal 1979 performance were as follows: equity investments and related mortgages yielded 13.0%; properties alone yielded 17.8% before depreciation charges; directly owned properties plus related mortgages yielded 20.1% before depreciation and 16.5% after depreciation; leasebacks and mortgages yielded 11.8%.

The trust portfolio is placing increasing emphasis on real estate ownership. Related mortgages on land leasebacks and limited partnerships totaled about $53 million at July 31, 1979; as these mortgages are repaid by refinancing arrangements with other lenders over the next few years, a significant kick to yields can be expected, especially as both the leaseback and partnership leases provide for escalations either through overages or increases tied to the Consumer Price Index. The trust's portfolio of non-related mortgage loans consists largely of mortgages made to facilitate the sale of foreclosed properties; addition to this are unlikely.

The size of the trust portfolio has remained relatively constant since early fiscal 1979; improving yields are more impressive in light of the difficulties which have curtailed expansion. Debt, including $58 million in commercial paper, was highly rate vulnerable, leading to sharply higher interest expense and preventing acquisitions, while the sale of non-earning assets (currently 10% of the portfolio, including low-earning assets) was slowed by money costs. The cost of debt was 12.4% in the first nine months of fiscal 1980; with the lower rates now prevalent, the trust can be expected to replace short-term debt with long-term capital and resume portfolio expansion.

The trust is paying dividends at an annual rate of $1.20, currently yielding 6.8%. In fiscal 1979, dividends were 79% capital gains. While the share price has recovered sharply from its 1980 low of 12-3/4 as rates have fallen, it remains below its early January high of 19-7/8. Thus, while a short-term surge is unlikely, intermediate- to long-term potential is high as the benefits of rate declines combined with higher yields as mortgages are paid off are felt. The No. 2-Ranked shares are an attractive long-term purchase and a strong hold.

Connecticut General Mortgage & Realty (25-3/8, NYSE), while based in Springfield, Mass., is concentrating an increasingly important portion of its investment portfolio in California. In the past four years, the trust has invested only in properties, and its portfolio is now evenly divided between properties and mortgages. About $150 million in



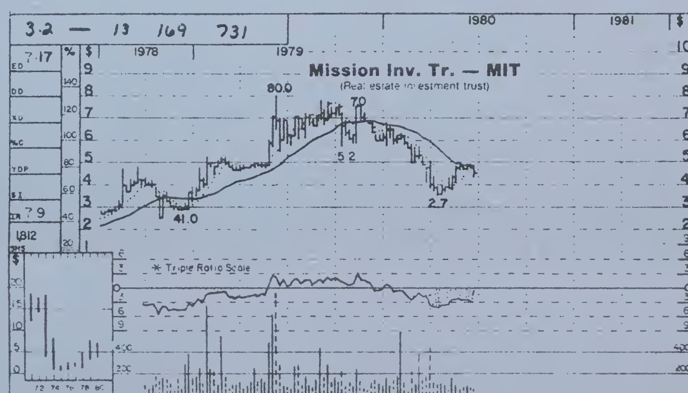
equities consists of 60% owned real estate, 32% partnerships, and 8% land purchase leasebacks. The mortgage loan portfolio of $154 million includes $35 million of mortgage debt on owned properties. The total portfolio is composed as follows: retail, 36%; industrial and other, 26%; apartment buildings, 16%, office buildings, 16%; hotels, 5%.

The cash return on equity for the fiscal year ended in March, 1980, was 14.4%, derived as follows: the mortgage portfolio yielded 9.4%; partnerships, 23%; owned real estate, 14%; leasebacks, 17.2%. Properties acquired before fiscal 1976 yielded 18.6%.

The trust's new commitment activity has been concentrated on partnership investments, in which the trust participates with local developers in the creation of new properties, in preference to competing for the purchase of existing properties. At March 31, 1980, the trust had $48 million interest in $166 million partnership properties ($200 million before depreciation deduction), with an additional $36 million in commitments outstanding. The importance of California investments in the trust portfolio is emphasized in that while California properties account for 29% of the total investment portfolio, more than triple the size of the next largest concentration by state, fully half of the partnership investments are located in California. The trust is deferring distributions from partnerships in excess of net income (largely resulting from depreciation) until such time as partnership investments are disposed of, in order to augment capital gains on dispositions when they occur.

Trust earnings have been largely invulnerable to interest rate swings; most of its debt is fixed rate, including $90 million term debt due through 1992, mostly at 8.75%, and $69 million of 6% convertible debentures due 1996, convertible at $32.50, which the trust has been repurchasing in the market at discounts for sinking fund payments (beginning May, 1981). Total interest expense on all debt amounted to approximately 8% for all of fiscal 1980.

The shares are trading near their 1980 high, currently yielding 7.9%. (The fiscal 1980 distributions were 12% return of capital and 12% capital gain.) A dividend reinvestment plan is available, providing for the purchase of shares at a 5% discount from the market price. In the immediate term, the shares are mainly income vehicles, with long-term gains potential strong on buildups from partnerships and eventual dispositions. The No. 1-ranked shares at a 24% premium over adjusted book value of $20.50, are recommended for long-term purchase.



<u>Mission Investment Trust</u> (4-5/8, ASE) is based in San Diego; its major assets are located in California and Texas and it is expanding into other real estate activities in California. During fiscal 1979, the trust made two great advances, emerging from litigation surrounding a condo property in San Diego, and paying off its $7 million

bank debt.

The trust's $25 million portfolio is 29% mortgages (85% earning), 49% classed as income producing properties, and 12% non-income producing properties. The mortgage loan portfolio yielded 8.1% in the fiscal year ended November, 1979.

The properties classed as income producing are 45 condo units in Del Mar, north of San Diego, and 4½ acres of nearby beachfront land, and 104 condo units at Capri by the Sea in San Diego. Capri by the Sea had been the object of lengthy litigation which was resolved with the purchase by the trust of the 40% minority interest in the property; the property was then converted from a hotel to its intended purpose as a condo project. The San Diego condos were carried on the trust books at an average price of $76,000 at November 30, 1979; during the fourth quarter of fiscal 1979, 13 of the units were sold at an average price of $187,000, for a net gain of $81,000 on each. During the first quarter of fiscal 1980, 7 more units carried at an average cost of $100,000 were sold at $158,000, for a $58,000 gain per unit.

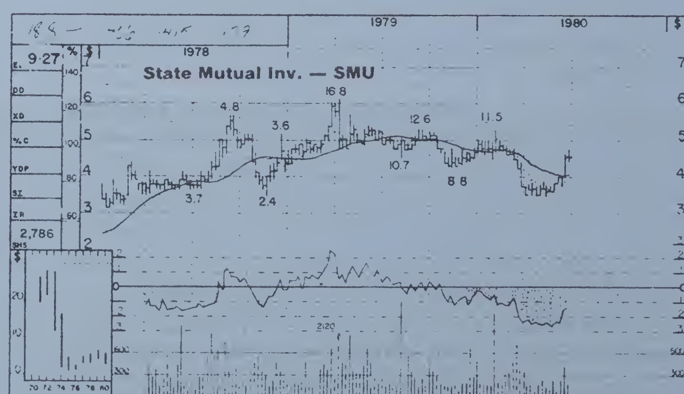
What is happening is that sale proceeds are being plowed back into improvements on the remaining units, raising the cost per unit to the trust. Additionally, the best condos have gone first, thus lowering the expected average selling price on the remaining units. The narrowing spread will somewhat restrict gains of the condo sales to an estimated $35,000 to $40,000 per unit, or to approximately $2.30 to $2.65 a share for the 120 units remaining after the end of the February quarter.

In regard to the other two major holdings, the Del Mar condos are carried at a $41,000 average net cost and thus have substantial appreciation potential; however, litigation must be settled before the units can be sold and they are currently rented as apartments. Similarly, the trust has an agreement to sell its 326 acres of undeveloped land near the Dallas-Fort Worth airport for a price "significantly" above its $3.6 million carrying value, but litigation regarding the title to the land must be worked out before the sale can be closed.

The other immediate problem facing the trust is the payment of its $12 million loan from Security Pacific National Bank, utilized to pay off its earlier revolving credit agreement and to buy out the minority interest in Capri by the Sea. Trust results had been restricted by interest at prime plus 2½% on the note; all trust assets have been pledged to secure the note, which is due August 27, 1980.

Trust long-range plans involve the continuing liquidation of its portfolio and reinvestment in income property providing distributable funds. Three California real estate brokerage firms were organized in fiscal 1979; at the moment they are respectively engaged in managing, selling, and marketing as time-shares the Capri by the Sea condo units.

Mission remains a long-term workout situation especially because remaining litigation will hinder asset liquidation; new activities are still in the conjectural stage. But at a 27% discount from book value at February 29, 1980 with meaningful gains to be realized in the short term on the San Diego condo sales, the No. 1-Ranked shares remain an interesting speculative purchase.



State Mutual Investors (4½, NYSE) is based in Worcester, Mass., but the recent acquisition of Greenville Corp. has resulted in a portfolio in which the most important assets are located in

California.

Greenville Corp. was owned by interests associated with Samuel, Hyman and William Belzberg, Canadian investors; its assets totaled $22 million, including $8.6 million in the Laderbel Business Park in Anaheim, Calif., $7.5 million of land in San Juan Capistrano, Calif., and $4.2 million in mortgage notes with an effective 13% yield. As a result of the merger, the Belzbergs now own 50.3% of the common shares of State Mutual.

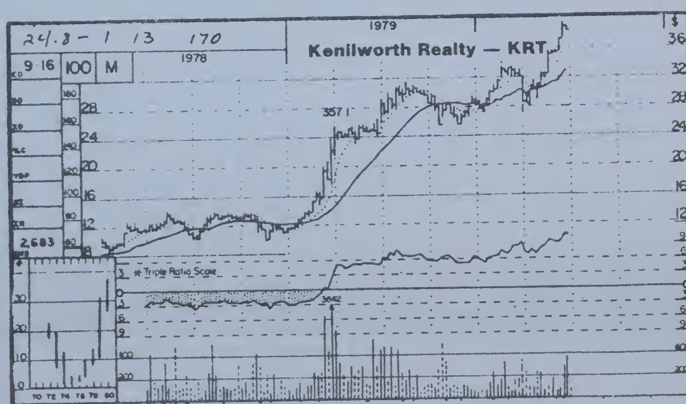
At January 31, 1980, the two California properties accounted for 39% of the company's portfolio and 62% of the earning assets. The two properties are under development; Capistrano contains a total of 264 acres of which 158 acres will be developed into 132 residential lots, 33 acres will be developed by the city, and the balance either sold as raw land or developed. The company sold 7.5 acres of Laderbel in February 1980; 30 buildings were planned for the remaining 20 acres, with 21 substantially completed by April 30, 1980 and the remaining 9 to be started by November, 1980. The bulk of the company's activities in the current fiscal year will be concentrated on these two properties.

The company plans for its future activities the construction of industrial and commercial properties for resale, the acquisition of land for development and resale in bulk lots, and condominium conversions. However, its high level of non-earning assets (66%), mostly undeveloped land, make the near-term realization of some revenues on the Greenville assets an important consideration. The company has $6.2 million of 9% notes due November 15, 1980, constituting the bulk of its debt, but has arranged for a $5 million credit line. The company's advisory agreement with State Mutual Life expires February, 1981, and more active involvement by the Belzbergs remains a strong possibility. (The value put on the State Mutual shares at the time of the merger was $5.) The company's tax loss carryforwards of $20 million do not begin to expire until 1983. Currently selling at a 36% discount from book value, the shares are an interesting speculation. We retain the No. 2N Ranking.

LIQUIDATION ARBITRAGES: KENILWORTH AND FRANKLIN REALTY REDUCED TO NO. 2 RANK

We now see both Kenilworth Realty and Franklin Realty stocks so high priced relative to potential liquidation proceeds that new purchases are attractive mainly to arbitrageurs only. Both seem to hold arbitrage potential but the fat part of their moves clearly is behind.

Hence we are dropping both to No. 2 Rankings because they are no longer suitable for most longer-term capital gains oriented investors. This is not a sell recommendation to subscribers who bought when we first moved the stocks to No. 1, as explained below. Normally we try to find stocks with potential for bringing you long-term capital gains treatment after a one-year holding period. But both these stocks ran up so quickly that we are issuing special advice to protect long-term gains for you, as follows:



Kenilworth Realty (38¼-NYSE) was moved to No. 1 less than two months ago, May 23, when it sold at 35½. Since then it has run up to 40-3/8 before pulling back about 2 points in reaction to release of Kenilworth's proxy for the Aug. 5 shareholders' meeting on the previously announced liquidation plan.

Some investors apparently seized upon disclosure that all pending sales contracts, if closed, would only bring net book value to $40.10/share. We are

also told that hedge fund operator Robert Wilson, part of the group that took control of Kenilworth last summer, offered his 163,000 shares for sale and the market took most at 39. Wilson bought his shares several years back at an average of about $4, so his desire to lock in long-term capital gains is understandable.

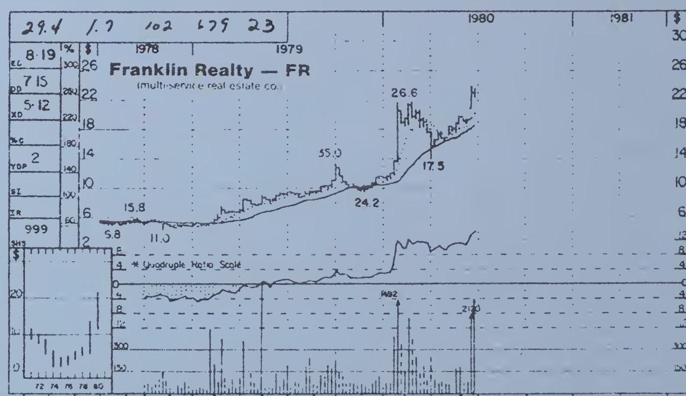
But KRT's pro forma balance sheet also includes $2.20/sh. depreciation that we at Audit would add back since sale experience to date indicates that it will be recaptured on most sales. To recap since our May 23 discussion, here is how Kenilworth's sales contracts signed to date, in expectation of a favorable liquidation vote, work out. Keep in mind Audit adds back accumulated depreciation to net book value of a cash flow trust like Kenilworth to approximate market value of properties. As it turns out, pending sales far exceed KRT's adjusted book value per share as follows:

	Net book	Deprec.	Adj. book
Feb. 1980....	$18.09	$5.43	$23.52
Pending sale gains......	22.02	(3.23)	18.79
Pro forma....	$40.10	$2.20	$42.30
Remaining props. (Audit est.).	NA	NA	$2.00-3.00
EST. TOTAL...			$45.00

Pending sale contracts and completed sales since May 23 would add $18.79 to adjusted book value, most gains from selling two Manhattan offices, 750 Third and 485 Lexington with 1.4 mil. sq. ft., for $65 million net of mortgages. That would net $19.73/sh. including $2.04/sh. depreciation recapture. But sale won't close for about nine months, until April 15, 1981, so that the big cash payout from KRT's liquidation is sometime away. That makes the stock less attractive as an arbitrage.

Properties remaining after these sales plus interim cash flow should add about $2-$3/sh. to liquidation proceeds, we estimate. KRT will own 1,405 apartments in four projects: one of 351 units is higher-rent probably suitable for condo conversion; three are middle-rent projects likely to sell for less. On balance we think the four may fetch about $2/share or a bit more over gross cost. The other significant property is 463,000 sq. ft. Truman Corners shopping center, Grandview, Mo., which is reported having competitive problems and thus might sell for not much over its $8.6 million cost. Add $1 or so per share for cash flow during the one-year liquidation period and you have our $45/share liquidation estimate, as per above and the May 23 REALTY TRUST REVIEW.

Current advice: Holders at our recommended 35½ can hold for liquidation distributions, mostly in the spring of 1981. Distributions would be long- or short-term capital gains, depending on your holding, so the tax breaks make the wait worth money costs. New positions may be established on dips near 35 but we'd not chase the stock over 38-40, since money costs start biting there.



Franklin Realty (24¼--ASE) shares are in a similar spot but the stakes are higher for subscribers. We picked FR as a No. 1 last Dec. 7 when it traded at 10¼; it has soared 137% in the seven months but we are still five months from going long-term. This is much too early to think about selling short against the box (i.e., against long positions) to lock in the gain, so we are suggesting you hold while trustees and management move ahead on a liquidation plan.

Status of the liquidation proposal is as follows: Trustees have asked management to develop a plan looking toward liquidation of FR's real estate portfolio. The plan will make adequate provision for meeting FR's obligations as a general partner in existing and planned real estate syndications; preserve existing property management, leasing, commercial and

industrial brokerage, and mortgage brokerage; and provide for employees. The plan should be presented to FR shareholders at the October annual meeting.

In preparation for the vote, FR has called for redemption the $4.5 million of 7% subordinated convertible debentures whose holders may convert into common at $10 per share through July 23. The call effectively should force conversion and would increase FR shares to 1,508,000.

Landauer Associates of New York City recently appraised FR property holdings at $28.67 per fully diluted share, but management cautions that this value does not take into account any sale costs or tax consequences in a liquidation. And even after liquidation proceeds were distributed, FR would apparently continue as a property syndicator, property manager, and real estate and mortgage broker. We tentatively value the ongoing entity at $2-$5/share but precise valuation must await completion of the formal plan.

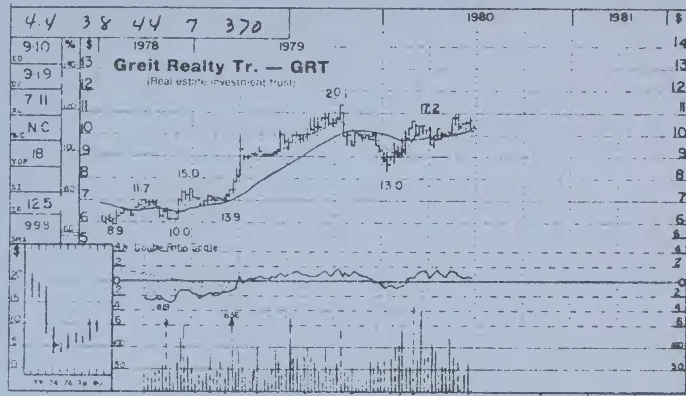
Hence we put the stock as a strong hold for subscribers with a low cost. New commitments are suitable only as an arbitrage on value of the ongoing entity.

Denver REIA (30 bid--OTC) is apparently proceeding with plans for bulk sale of its properties to a Chicago real estate man. The sale is expected to net about $35/sh. liquidation proceeds. We have not previously recommended Denver and believe it is a more difficult arbitrage at these prices (the 31¼ asked price gives such a wide spread that trading is probably suitable only for professionals).

Real Estate Investment Properties (10¼ bid--OTC) has given up plans to sell its six Vagabond Motel properties and distribute proceeds. REIP had been asking a price that would have netted about $15-$16/share. Abandonment signals the fact that not every REIT portfolio can be liquidated quickly at premium prices, even when management is willing.

RANKING CHANGES: GREIT REALTY ELEVATED TO NO. 1 ON IMPROVED EARNINGS PROSPECTS

We are raising GREIT Realty Trust (10-3/4--ASE) to No. 1 Ranking, in the income plus long-term growth group.



GREIT Realty epitomizes the stock market truism that the time to perk up your interest is when a once-stodgy company kicks up its heels and starts dancing on the table. It's a risky time because newly-bold management may venture into unfamiliar areas, but it can also be a rewarding signal if the change-of-life entity has a good chance of success.

We believe the market hasn't caught up yet with the deep changes inside GREIT now that Canadian financier George Mann and his Unicorp Financial Corp. of Toronto have taken control. Unicorp owns about 40% of GREIT's 997,500 shares at an average cost of about $8.60/share. Mann is a trustee and member of the executive committee. Mann is a cautious investor and Unicorp also holds positions in First Union RE (7.0%), REIT of America (9.8%), and San Francisco REI (8.3%). All --with exception of GREIT--are well managed trusts paying adequate dividends. Since Mann's entry, GREIT has made these changes:

The portfolio is improved. On April 30 GREIT sold its largest and most questionable investment, 560,000 sq. ft. Northside shopping center in Miami, Fla. Center income and cash flow had been declining gradually and near-term lease expirations raised concern because of a declining trade area and competition from newer ceneters. (The center is in the Miami section hit by riots in late May.)

Northside represented about 29% of gross cost of GREIT's property holdings and its sale removes a cloud and paved the

way for improved yield. The buyer, a Netherlands Antilles company, paid $9 million ($1.5 million cash, $2.2 million in 10-year note, and mortgage assumption). GREIT must still collect the $2.2 million note, which is backed by letters of credit. While GREIT lost $520,000 on the deal, we see the sale as a major positive.

GREIT retains one other large shopping center, 475,000 sq. ft. Hillside enclosed mall center in Hillside, Ill. 15 miles west of Chicago's loop. Hillside too is encountering competition but a 1976 improvement program and leasing of parcels for a hotel and theater improve results. Hillside is 26% of gross property cost.

Major remaining problem is GREIT's third largest property, 216,000 sq. ft. Talbott Towers office in Dayton, O. It is now over 80% leased but won't be cash flow positive for another year. It has been a cash drain since 1978 when Mead Paper Co. vacated 65% of space.

GREIT operations netted 30¢/sh. in six months through April, up 20% from 1979 and operating cash flow for the first half rose a smaller 14% to 44¢/sh. We do not expect any dramatic change in this gradual improvement in the Oct. 1980 fiscal year. Until now we have not evaluated GREIT on a net cash flow basis because we felt Northside's depreciation and value were uncertain. With Northside gone, we will now evaluate GREIT's net cash flow.

New management is moving toward holding company format. GREIT has used some proceeds from Northside to buy 12,200 sh. and about 260,000 warrants of San Francisco Real Estate. The warrants, which we estimate cost GREIT about $2.40 each, are exercisable at $25 through Dec. 31. If GREIT exercises, it would own about 16% of SFI while Unicorp holds another 8%. Mann says present intention is that GREIT will in fact exercise later this year for about $7.4 million total investment in SFI. And Unicorp has just agreed to buy the warrants if GREIT can't come up with funds to exercise, in effect guaranteeing that SFI will receive the new money. Mann disclaims any takeover intent; rather, it's a way of hiring the strong SFI management to manage GREIT's funds.

And if SFI can maintain its $1.76 dividend, GREIT's purchase could generate $475,000/yr. dividend income that could either pay interest carrying costs or increase GREIT's own dividends to a much smaller share capitalization. Going-in yield would be a mediocre 6½% to GREIT but longer-term potentials are good.

What's GREIT worth? GREIT comes out of Northside with $11.14/sh. net book value plus about another $11.25/sh. accumulated depreciation. Some of this is likely "real" depreciation so we prefer to visualize market value of properties at about $16-$18/share. Current yield on book value is the lowest of all property trusts, so the leverage for new share purchasers is management's ability to bring yield (and dividend) up to competitive rates. GREIT now has made a good start and presence of a financial godfather adds ability to raise funds. We would buy.

STOCKS IN THE NEWS: INSIDERS BUY BLOCK AT PROPERTY TRUST; FIRST PENN DEAL

A group of insiders has bought about 500,000 sh. or 21% of Property Trust of America, thus giving the trust much more control over its destiny. The shares changed hands at 8-7/8, which is also the recent bid price. Buyers include El Paso businessman and new PTA trustee James Cardwell, 250,000 sh.; Cardwell business associate Gilbert Russell 160,000 sh.; former trustee Charles H. Leavell 50,000 sh.; and Managing Trustee James Polk 50,000 sh.

First Pennsylvania Mortgage (1-3/8--NYSE) continues to talk about capital restructuring with Hallwood Metropolitan Holding, Ltd. of London. The deal would include buying FPM's $39.8 million bank debt at a deep discount and a rights offer to existing holders (a la Maryland Realty -- RTR May 12) in which Hallwood would guarantee unexercised rights. Banks hold the key and outcome is uncertain; substantial additional shares would likely result and we don't see FPM shares as a dynamic speculative prospect despite price near its low for the year.